IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

DAVID JACOBS and GARY HINDES, on behalf of themselves and all others similarly situated, and derivatively on behalf of the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, Plaintiffs, v. THE FEDERAL HOUSING FINANCE AGENCY, in its capacity as Conservator of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, and THE UNITED STATES DEPARTMENT OF THE TREASURY, Defendants, and THE FEDERAL NATIONAL MORTGAGE ASSOCIATION and THE FEDERAL HOME LOAN MORTGAGE CORPORATION, Nominal Defendants.	)	C.A. No. 15-708

REPLY BRIEF IN SUPPORT OF MOTION TO DISMISS OF FHFA, FANNIE MAE, AND FREDDIE MAC

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INTRODUCTION[1]

Plaintiffs' Opposition to the Motions to Dismiss cannot create jurisdiction where federal law plainly has withdrawn it. Nor can the Opposition nullify provisions of federal law governing the operations of Fannie Mae and Freddie Mac while in conservatorship. That law irrevocably vests the FHFA, as Conservator of the Enterprises, with "all rights, titles, powers, and privileges" of the Enterprises and their shareholders. Plaintiffs cannot avoid the dispositive consequences of these federal statutory directives by arguing that state law controls. In short, state law does not preempt and supersede the controlling provisions of the Enterprises' federal statutory charters and the federal statutes, enacted less than two months prior to the placement of Freddie Mac and Fannie Mae into FHFA conservatorships, which explicitly bar Plaintiffs' entire complaint.

Plaintiffs' claims are nothing new. Other courts have considered and dismissed almost identical complaints challenging the Conservator's ability to amend the financing agreements by which Treasury rescued the Enterprises from insolvency and mandatory receivership. Plaintiffs contend the Third Amendment was too favorable to Treasury, even though Plaintiffs provided ***no*** capital to save the Enterprises (their shares were issued before the Enterprises' conservatorships) and Treasury invested billions in taxpayer capital at a time of historic distress and remains contractually bound to infuse as necessary an additional quarter-trillion dollars in support of ongoing Enterprise operations. The courts have unanimously and correctly concluded that shareholders such as Plaintiffs have no right to interfere with the Conservator's operation of the Enterprises, and that (1) HERA bars claims for injunctive or equitable relief, including the specific relief Plaintiffs seek here; and (2) HERA transfers to the Conservator "***all rights***, titles,

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[1] Capitalized terms not defined herein shall have the meanings set forth in FHFA, Fannie Mae, and Freddie Mac's Opening Brief (Dkt. 18) ("FHFA OB"). "TOB" means Treasury's Opening Brief (Dkt. 20), and "PB" means Plaintiffs' Opposition Brief (Dkt. 23).

powers, and privileges" of the Enterprises and their shareholders, thereby precluding shareholders from bringing any claims that arise from or relate to their status as shareholders, including claims based on the Third Amendment. There is no basis to depart from the plain language of HERA or the sound reasoning of the courts that have dismissed similar claims.

The only remotely new argument Plaintiffs present here is that the corporate laws of Delaware and Virginia supposedly override governing federal law and prohibit the Conservator from setting a preferred stock dividend that leaves the Enterprises with insufficient capital to pay dividends to more junior stock. But that argument is plainly wrong and cannot save the Complaint from dismissal. *First*, neither Delaware nor Virginia law applies. Federal law controls, and it expressly authorizes the Enterprises to (1) issue preferred stock "on such terms and conditions as the board of directors shall prescribe" (12 U.S.C. § 1718(a); *id.* § 1455(f)), and (2) make dividend payments to Enterprise stockholders in the manner "as may be declared by the board of directors." *Id.* § 1718(c)(1); *id.* § 1452(b)(1). Further, HERA gives the Conservator authority to determine how to fund and operate the Enterprises. No conflicting state law can circumscribe the broad powers federal law confers on the Conservator. *Second*, even if state law controlled—and it does not—the Third Amendment violates none of the state law provisions, including those relating to preferred stock, on which Plaintiffs rely.

Accordingly, the Complaint should be dismissed in its entirety.

ARGUMENT

I. Section 4617(f) Bars Plaintiffs' Equitable and Declaratory Claims

Plaintiffs seek far-reaching equitable and declaratory relief, including an order voiding the Third Amendment—thereby seeking to substitute their judgment for the Conservator's about the appropriate way to capitalize and operate the Enterprises. *See* Compl. Prayer for Relief (C), (I); PB 29. As multiple courts have concluded, HERA (12 U.S.C. § 4617(f)) bars these claims

because they seek relief that would "restrain or affect the exercise of powers or functions of [FHFA] as a conservator." *See* FHFA OB 10-18; TOB 15-18.[2] Plaintiffs' opposition cannot sidestep the dispositive effect of Section 4617(f).

Plaintiffs concede that Section 4617(f) bars their claims if the Conservator acted within its powers or functions when it executed the Third Amendment. PB 31-33. And Plaintiffs do not dispute that HERA gives the Conservator broad powers to, *inter alia*, carry on the business of the Enterprises, enter into contracts on their behalf, and transfer or sell Enterprise assets. *See* 12 U.S.C. § 4617(b)(2). Plaintiffs nevertheless argue the Conservator's powers and functions must be narrowly defined and are limited by state law. PB 34-41. That is wrong: Plaintiffs' interpretation of the Conservator's scope of authority is contrary both to the express text of HERA and the holdings of every court to have considered the issue.

A. HERA Grants the Conservator Broad Powers and Functions That Are Not Constrained by State Law

Plaintiffs contend that, because the Conservator succeeded to all of the "rights, titles, powers, and privileges" of the Enterprises and their officers and directors (12 U.S.C. § 4617(b)(2)(A)(i)), the Conservator "must comply with the same corporate charters, bylaws, *state laws*, and other rules that governed these entities' officers and directors prior to the conservatorship." PB 35 (emphasis added). Plaintiffs further argue that the Conservator allegedly violated state law concerning the permissible structure and dividend policies of preferred stock in executing the Third Amendment, and therefore the Conservator purportedly

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[2] Because restitution, as requested by Plaintiffs, is equitable relief, Section 4617(f) deprives the Court of jurisdiction to award it and bars the return of dividends paid pursuant to the Third Amendment. *See Porter v. Warner Holding Co.*, 328 U.S. 395, 402 (1946) (noting that restitution that "restor[es] the status quo" is a power "of a court of equity"); *United States v. Brown*, 587 F. Supp. 1005, 1007 (E.D. Pa. 1984) ("[A]t equity, restitution was considered a remedy by which a defendant is made . . . to restore the status quo." (internal quotation marks and citation omitted)).

acted outside of its powers or functions. On this basis, Plaintiffs contend that Section 4617(f) does not apply—*i.e.*, any time a plaintiff alleges that the Conservator violated state law, the jurisdiction-withdrawal provision of HERA becomes a nullity. *See id.* at 34-38.

But the Third Circuit has repeatedly rejected this very argument, holding that, so long as a conservator or receiver is carrying out one of its statutorily-defined powers or functions, courts are prohibited from enjoining that conduct, *even if* the conservator or receiver allegedly violated state law, federal law, or its own regulations in the process. For example, in the leading Third Circuit opinion, *Rosa v. Resolution Trust Corp.*, the plaintiffs attempted to enjoin the RTC as conservator and receiver based on its alleged violation of ERISA. 938 F.2d 383 (3d Cir. 1991). As here, the plaintiffs in *Rosa* argued that "while RTC as conservator and receiver is authorized to run the affairs of a troubled institution . . . it is only authorized to run them in a legal manner." *Id.* at 397. The plaintiffs argued that "illegal" conduct "was not among the 'powers or functions of the Corporation as a conservator or a receiver.'" *Id.* The Third Circuit squarely rejected this argument: "[w]e find no such limitation in the language of § 1821(j)," the analogous jurisdiction-withdrawal provision under FIRREA. *Id.* The court instead held the powers of the conservator and receiver were "defined by" their governing statute, FIRREA, without any exception or limitation for compliance with other laws. *Id.* at 398. The Third Circuit concluded that the RTC's actions fit within its "quite broad" statutory powers as conservator and receiver, and thus Section 1821(j) barred plaintiffs' demands for equitable relief. The court "naturally express[ed] no opinion as to the alleged wrongfulness of RTC's conduct." *Id.* at 400; *see also Gross v. Bell Sav. Bank PaSA*, 974 F.2d 403, 407 (3d Cir. 1992) (reaffirming *Rosa* and observing that "where the [conservator or receiver] performs functions assigned it under the statute, injunctive relief will be denied *even where [it] acts in violation of other statutory schemes*" (emphasis added)).

Since *Rosa* and *Gross*, many other courts—including the Fourth, Fifth, Eleventh, and D.C. Circuits—also have embraced the same principle, holding that compliance with other laws, including state laws, cannot constrain the powers and functions of a conservator or receiver.[3] Indeed, to hold otherwise would effectively negate the jurisdiction-withdrawal provisions of Sections 4617(f) and 1821(j), as every plaintiff's claims against a conservator or receiver necessarily allege some type of unlawful conduct, which—under Plaintiffs' view—would remove the protections of the statute. *See Rosa*, 938 F.2d at 397 (observing that a limitation on Section 1821(j) for compliance with other laws "would undermine the purpose of the statute, namely, to permit [the] conservator or receiver to function without judicial interference"); *Volges*, 32 F.3d at 52-53 ("If every party to an executory contract entered into by the [conservator or receiver] could obtain injunctive relief to prevent an alleged breach, the anti-injunction mandate would be severely restricted, if not meaningless.").

Plaintiffs themselves reluctantly acknowledge this principle in a footnote, observing that "[these] cases are best understood to mean only that Section 1821(j) applies even when a conservator or receiver violates some law *other* than FIRREA." PB 33 n.39 (emphasis in

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[3] *See, e.g.*, *In re Landmark Land Co. of Carolina*, No. 96-1404, 1997 WL 159479, at *4 (4th Cir. Apr. 7, 1997) ("The mere fact that an action of the FDIC [as conservator or receiver] may violate state contract law . . . does not entitle a federal court to enjoin the FDIC . . . ."); *RPM Invs., Inc. v. Resolution Tr. Corp.*, 75 F.3d 618, 621 (11th Cir. 1996) ("Even claims seeking to enjoin the RTC [as conservator or receiver] from taking allegedly unlawful actions [*i.e.*, breaching a contract] are subject to the jurisdictional bar of 1821(j)."); *Volges v. Resolution Tr. Corp.*, 32 F.3d 50, 52 (2d Cir. 1994) ("The fact that the [conservator's or receiver's conduct] might violate [plaintiff]'s state law contract rights does not alter the calculus [under Section 1821(j)]."); *Ward v. Resolution Tr. Corp.*, 996 F.2d 99, 103 (5th Cir. 1993) (rejecting illegality limit on receiver's powers and observing the plaintiff "fails (or refuses) to recognize the difference between the exercise of a function or power that is clearly outside the statutory authority of the RTC on the one hand [and thus not protected by Section 1821(j)], and improperly or even unlawfully exercising a function or power that is clearly authorized by statute on the other [and thus protected by Section 1821(j)]"); *Nat'l Tr. for Historic Pres. v. FDIC*, 995 F.2d 238, 240 (D.C. Cir. 1993) ("We do not think it possible, in light of the strong language of § 1821(j), to interpret the FDIC's 'powers' and 'authorities' to include the limitation that those powers be subject to—and hence enjoinable for non-compliance with—any and all other federal laws.").

original). But Plaintiffs never reconcile this principle with their facially inconsistent argument that Section 4617(f) does not apply where the Conservator allegedly violates state law, which is, in Plaintiffs' words, "some law *other* than [HERA]." *Id.*

The authorities Plaintiffs cite are not to the contrary. At most, they stand for the proposition that, if a conservator or receiver violates state law in carrying out its powers or functions, it may in some circumstances be required to defend claims for money damages—but not equitable relief. For example, in *Bank of Manhattan v. FDIC*—cited repeatedly by Plaintiffs—the Ninth Circuit addressed only whether FIRREA "immunize[s] the FDIC [as receiver] from *damage claims* if it elects to breach pre-receivership contractual arrangements." 778 F.3d 1133, 1134 (9th Cir. 2015) (emphasis added). The Ninth Circuit held that the receiver's succession to the rights and powers of the failed institution did not permit it to "breach pre-receivership contracts without consequence," but the court did not enjoin such a breach or otherwise award equitable relief. *Id.* at 1137. In fact, the district court—in a ruling the Ninth Circuit did not disturb on appeal—rejected plaintiff's claim for specific performance of the contract based in part on the conclusion that Section 1821(j) of FIRREA bars such relief.[4] Moreover, the other case Plaintiffs rely upon, *Ridder v. CityFed Fin. Corp.*, is wholly inapposite; it does not even mention Section 1821(j), nor does it address the scope of a conservator or receiver's power under FIRREA (or, of course, HERA). 47 F.3d 85 (3d Cir. 1995).[5]

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[4] Memorandum and Order at 17 n.4, *Plaza Bank v. FDIC*, No. 2:10-cv-4614 (C.D. Cal. Oct. 4, 2011), Doc. No. 78.

[5] Although the Ninth Circuit in *Sharpe* found Section 1821(j) inapplicable because "FIRREA does not authorize the breach of contracts," the Ninth Circuit and other courts have since limited that decision to its facts—namely, an alleged breach of a ***pre-receivership*** settlement agreement concerning the recording of the reconveyance of a deed of trust. *See, e.g., Meritage Homes of Nev., Inc. v. FDIC*, 753 F.3d 819, 825 (9th Cir. 2014) (observing *Sharpe* "is not controlling outside its limited context"); *Deutsche Bank Nat'l Tr. Co. v. FDIC*, 744 F.3d 1124, 1136-37 (9th Cir. 2014) (observing *Sharpe* cannot sustain an "expansive interpretation" and was "limited to its particular facts"); *McCarthy v. FDIC*, 348 F.3d 1075, 1078-79 (9th Cir. 2003) (observing

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Plaintiffs fare no better in arguing the Conservator acted outside of its powers and functions by allegedly breaching Plaintiffs' contracts without following the repudiation procedures outlined in 12 U.S.C. § 4617(d). *See* PB 36-37. This is simply a reformulation of Plaintiffs' failed argument that the Conservator's powers and functions are limited by the need for compliance with state law regarding contract rights. The related allegation that the Conservator failed to repudiate within a reasonable time does not mean the Conservator acted outside its authority, and cannot avoid the jurisdictional bar of Section 4617(f). *See MBIA Ins. Corp. v. FDIC*, 708 F.3d 234, 247 (D.C. Cir. 2013) (applying Section 1821(j) notwithstanding allegation that the receiver failed to repudiate a contract in a timely manner under FIRREA); *Bender v. CenTrust Mortg. Corp.*, 833 F. Supp. 1540, 1542 (S.D. Fla. 1992) *aff'd*, 51 F.3d 1027 (11th Cir. 1995) (same, notwithstanding allegation that receiver's repudiation of plaintiff's contract was beyond the scope of its authority).

B. The Third Amendment Was an Exercise of the Conservator's Powers and Functions Under HERA

The Third Amendment plainly falls within the Conservator's broad statutory powers and functions as enumerated in HERA. *See* FHFA OB 13-18; TOB 15-18. Plaintiffs offer a hodge-podge of arguments to the contrary, but all of them fall flat.

First, Plaintiffs argue the Third Amendment is not an agreement to transfer Enterprise assets, which is expressly authorized by 12 U.S.C. § 4617(b)(2)(G), because that provision

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"*Sharpe* was an unusual case" and declining to apply it outside "the circumstances [it] present[ed]").

Moreover, *Sharpe* is also inconsistent with the Third Circuit's binding precedents in *Rosa* and *Gross*, which hold a conservator's powers and functions are defined exclusively by governing federal statutes. *See also Mile High Banks v. FDIC*, No. 11-cv-01417, 2011 WL 2174004, at *3-4 (D. Colo. June 2, 2011) (finding *Sharpe* "unpersuasive" and citing *Gross* (3rd Cir.) to apply Section 1821(j): "[T]he Court finds that, regardless of whether the sale would breach any contract, such breach is immaterial to the Court's analysis of whether it has jurisdiction to enjoin the sale.").

applies only to asset transfers made by FHFA as "conservator or receiver," and—according to Plaintiffs—FHFA "was not acting in either capacity" when it executed the Third Amendment. PB 39. The *first paragraph* of Plaintiffs' own complaint defeats this facile argument by alleging that the Third Amendment was executed by FHFA "in its capacity as conservator of Fannie Mae and Freddie Mac." Compl. ¶ 1. In addition, the Third Amendment itself confirms that it was executed by each Enterprise "acting through [FHFA] as its duly appointed conservator." *See* FHFA OB, Ex. A at 52.

Plaintiffs' argument that FHFA was not acting in its conservatorship capacity because it supposedly failed to "maximize . . . value" boils down to a challenge to the merits and effectiveness of the Conservator's decision to execute the Third Amendment. *See* PB 39 (arguing Third Amendment was executed in exchange for "virtually nothing"). Although Plaintiffs say that they do not rely on an argument that the Conservator "did a bad job" (PB 37), that is in fact the keystone to their contention that the Conservator acted outside its scope of authority. Section 4617(f) was designed to preclude precisely this kind of second-guessing. *See Ward*, 996 F.2d at 103 (Section 1821(j) bars claims despite allegation that the receiver "failed to maximize the net present value return" on sale of assets); *see also Cty. of Sonoma v. FHFA*, 710 F.3d 987, 993 (9th Cir. 2013) ("[I]t is not our place to substitute our judgment for FHFA's" as Conservator); *Nat'l Tr.*, 995 F.2d at 240 (Section 1821(j) "immuniz[es]" conservator from all "outside second-guessing").[6]

[6] In a further twist on the "bad job" theory of liability, Plaintiffs also suggest the Conservator violated a "duty" and "obligat[ion]" to preserve and conserve Enterprise assets, and an alleged "require[ment]" to "'rehabilitate' the Companies for eventual return to normal business operations." PB 38-39, 42. HERA's plain text defeats this argument. HERA ***confers powers*** on the Conservator and bars second-guessing by shareholders; it does not ***impose duties*** that the Conservator owes to shareholders, or invite shareholders to challenge the Conservator's decisions.

Second, Plaintiffs argue the Conservator's statutory power to transfer Enterprise assets is limited by the receivership-distribution priority scheme outlined in HERA. PB 39-40 (citing 12 U.S.C. § 4617(b)(3)-(9), (c)). But the Enterprises are not in receivership, and thus the order of priority for distribution of assets in receivership is inapplicable. In all events, allegations that a conservator's conduct violates the statutory order of priority for receiverships are insufficient to overcome Section 4617(f). For example, in *Courtney v. Halleran*, the Seventh Circuit rejected the plaintiff's argument that an asset transfer was purportedly a "thinly disguised way of circumventing the statutory priority scheme and allowing the [investor] to get more than its proper share." 485 F.3d 942, 945 (7th Cir. 2007). The "glaring problem" with this argument, the court held, was that the receiver is specifically authorized to "transfer assets or liabilities without any further approvals," and thus the relief requested was barred by "the anti-injunction language of § 1821(j)." *Id.* at 948.

Third, Plaintiffs argue that while HERA may permit "specific transfers" of "discrete assets," it does not permit transfers "on the scale alleged here." PB 40. But neither HERA nor the authorities cited by Plaintiffs impose any limitation on the "scale" of asset transfers that the Conservator may make. Indeed, as the Ninth Circuit held, "nothing precludes a conservator from making business decisions that are both broad in scope and entirely prospective." *Cty. of Sonoma*, 710 F.3d at 994 (observing the "categorical nature" of the Conservator's conduct, "as opposed to a case-by-case" approach, "does not change the fact that FHFA's decision is in furtherance of" its statutory powers and functions).

Fourth, Plaintiffs fail in their attempt to distinguish *Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208, 218 (D.D.C. 2014). PB 41-42. In that decision, the court addressed state law claims that are materially identical to the state law claims Plaintiffs assert here for breach of

fiduciary duty, breach of contract, and breach of the covenant of good faith and fair dealing. *Id.* at 218. The court flatly rejected allegations that the Conservator violated Delaware and Virginia law by executing the Third Amendment, holding Section 4617(f) bars such claims. *Id.* at 221-29. *Perry Capital* is thorough and well-reasoned, and the Court should follow it here. *See Cont'l W. Ins. Co. v. FHFA*, 83 F. Supp. 3d 828, 840 n.6 (S.D. Iowa 2015) (following *Perry Capital* to conclude the Conservator acted within its statutory powers in executing the Third Amendment).

II. HERA Bars Shareholder Claims During Conservatorship

A separate provision of HERA also bars Plaintiffs' claims for equitable relief and money damages. In particular, 12 U.S.C. § 4617(b)(2)(A)(i) provides that the Conservator succeeds to "all rights, titles, powers, and privileges" of the Enterprises and their shareholders, including Plaintiffs. *See* FHFA OB 18-22. Thus, Plaintiffs possess no right to bring this Complaint, which presents only claims that relate to, or arise out of, their status as shareholders.

A. Under HERA, the Conservator Succeeds to Derivative and Direct Claims

Plaintiffs contend HERA's succession provision only affects shareholders' derivative rights, not their direct claims. PB 44-50. This contention cannot save the Complaint from dismissal for two reasons: (i) Plaintiffs' claims are derivative, and (ii) the succession provision applies to ***all*** shareholder rights, whether derivative or direct. 12 U.S.C. § 4617(b)(2)(A)(i).

1. Plaintiffs' Claims Are Derivative; HERA Has Transferred Them to the Conservator With No Exception For Alleged Conflicts-of-Interest

For the reasons stated in Treasury's briefs, Plaintiffs' claims are derivative. TOB 18-22; Treasury Reply Sec. III. Under HERA, the Conservator alone has standing to assert such claims.

Plaintiffs do not dispute that HERA generally bars derivative claims but they argue for a "conflict of interest" exception to HERA's succession provision. PB 50-53. Plaintiffs can point

to nothing in HERA—not a word—to so much as suggest that Congress intended a conflict-of-interest exception that would limit the Conservator's succession to "all rights, titles, powers, and privileges" of the shareholders and the Enterprises.

Instead, Plaintiffs rely wholly on two inapplicable, out-of-circuit decisions that have created a conflict-of-interest exception in sharply limited circumstances and applicable only to FDIC receiverships—not conservatorships. PB 51-52 (discussing *First Hartford Corp. Pension Plan & Tr. v. United States,* 194 F.3d 1279, 1295–96 (Fed. Cir. 1999) and *Delta Sav. Bank v. United States*, 265 F.3d 1017, 1021-23 (9th Cir. 2001)). *Perry Capital* rightly declined to apply these cases to FHFA conservatorships, explaining there was no basis for creating "an *implicit* end-run around FHFA's conservatorship authority by means of the shareholder derivative suits that the statute explicitly bars." 70 F. Supp. 3d at 231. This Court should follow suit.

First, *First Hartford* and *Delta Savings* are facially inapplicable. They created a conflict-of-interest exception only in the context of failed, non-operating banking institutions in *receivership*, not financial institutions operating in conservatorship. In those cases, the shareholders' contingent right to a distribution from the failed institution's liquidation arguably had ripened—a circumstance plainly not presented here, as the Enterprises continue to operate. Indeed, HERA expressly provides that, upon appointment of a receiver, shareholders gain the ability to assert claims based on their contingent rights through the administrative and judicial claims processes. 12 U.S.C. § 4617(b)(2)(K)(i). Shareholders have no such rights during conservatorship. *See id.* § 4617(b)(2)(A); *see also Perry Capital*, 70 F. Supp. 3d at 231 n.30 (noting conflict-of-interest exception "makes still less sense in the conservatorship context, where FHFA enjoys even greater power free from judicial intervention" than in receivership). Additionally, *First Hartford* and *Delta Savings* arose from actions of the regulator that preceded

and allegedly contributed to the imposition of receivership, and thus concerned rights that allegedly had ripened *before* receivership—a circumstance not presented here. *See First Hartford*, 194 F.3d at 1283-84, 1295; *Delta Sav.*, 265 F.3d at 1019-20.[7]

Second, *First Hartford* and *Delta Savings* were wrongly decided, as the court in *Perry Capital* recognized. HERA, like FIRREA, broadly transfers "all" shareholder "rights, titles, powers, and privileges" to conservators and receivers, which includes the ability to bring derivative suits on behalf of the Enterprises. *See Kellmer v. Raines*, 674 F.3d 848, 850 (D.C. Cir. 2012). "Unambiguous statutory language is generally enforced as written and may be departed from only on the most extraordinary showing of contrary intentions in the legislative history." *Hennepin Cty. v. Fed. Nat'l Mortg. Ass'n*, 742 F.3d 818, 821 (8th Cir. 2014) (internal quotation marks and citation omitted); *cf. Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837, 842 (1984) (Where "Congress has directly spoken to the precise question at issue . . . the intent of Congress is clear [and] that is the end of the matter."). Further, creating a judicial exception to HERA would be especially inappropriate because Congress "considered whether there was need for any exception and 'limited the statute to the ones set forth.'" *Hennepin Cty.*, 742 F.3d at 821 (quoting *United States v. Johnson*, 529 U.S. 53, 58 (2000)). The existence of this lone exception precludes any others, including one for "conflict of interest."[8]

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[7] *First Hartford* and *Delta Savings* are, by their own acknowledgment, exceptional cases. *See First Hartford*, 194 F.3d at 1295 ("[O]ur holding is limited to the situation here," and "[w]e neither infer nor express an opinion on the standing of derivative plaintiffs in other circumstances."); *Delta Savings*, 265 F.3d at 1022 (acknowledging the narrowness of the exception). And *Delta Savings* itself has been characterized as "a significant expansion" of what *First Hartford* "expressly warned was supposed to be a 'very narrow' holding." *Gail C. Sweeney Estate Marital Tr. v. U.S. Treasury Dep't*, 68 F. Supp. 3d 116, 123 n.9 (D.D.C. 2014).

[8] Plaintiffs argue that Congress endorsed *First Hartford* and *Delta Savings* by using the same language in HERA it used in FIRREA. PB 52. But two cases do not constitute a settled judicial construction of a statute. *Jama v. Immigration & Customs Enf't*, 543 U.S. 335, 351 (2005) (concluding that the "decisions of two Courts of Appeals" were not a "settled judicial construction nor one which we would be justified in presuming Congress, by its silence,

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Moreover, the court in *First Hartford* erred by relying heavily on the traditional derivative litigation concept, rooted in common law, that shareholders may bring suit on behalf of the corporation "when the managers or directors of the corporation, perhaps due to a conflict of interest, are unable or unwilling to do so, despite it being in the best interests of the corporation." *First Hartford*, 194 F.3d at 1295 (discussing *Kamen v. Kemper Fin. Servs.*, 500 U.S. 90, 95 (1991)). HERA's succession provision *eliminates* the distinction between shareholder interests on the one hand, and officer and director interests on the other; the conservator succeeds to *all* such interests and is alone empowered to determine what is in the "best interests" of the Enterprises. *See* 12 U.S.C. § 4617(b)(2)(J)(ii). The *Perry Capital* court rightly recognized as much, explaining that "courts cannot use the *rationale* for why derivative suits are available to shareholders as a legal tool—including the conflict of interest rationale—to carve out an *exception* to [HERA's] prohibition" on shareholder derivative suits during conservatorship. 70 F. Supp. 3d at 231. "Such an exception would swallow the rule." *Id.*[9]

Finally, Plaintiffs assert that not creating a conflict-of-interest exception could raise constitutional issues. PB 49. But Plaintiffs assert no constitutional claims, so their argument that

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impliedly approved" (citation omitted)). And "where the law is plain"—as here—"subsequent reenactment does not constitute an adoption" of the prior construction, *Brown v. Gardner*, 513 U.S. 115, 121 (1994), especially when there is "no direct evidence that Congress ever considered the issue . . . or voiced any views upon it." *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321, 336 n.7 (1971).

[9] Plaintiffs insist that a conflict-of-interest exception "would [not] swallow the rule" because the exception may not apply in "actions relating to corporate mismanagement that resulted in the imposition of the conservatorship or receivership in the first place." PB 52-53. But that was precisely the sort of conflict alleged in *First Hartford* and *Delta Savings* and for which the court (incorrectly) applied the exception. *See First Hartford*, 194 F.3d at 1283-84, 1295; *Delta Sav.*, 265 F.3d at 1019-20. Moreover, other shareholders *have* sought to apply a conflict-of-interest exception to the Conservator's decision whether to pursue claims based on pre-conservatorship corporate mismanagement, demonstrating that such an exception would, in fact, threaten to "swallow the rule." *See, e.g.*, *In re Fannie Mae Sec., Derivative, ERISA Litig.*, 629 F. Supp. 2d 1, 4 n.5 (D.D.C. 2009), *aff'd sub nom. Kellmer*, 674 F.3d 848; *In re Fed. Home Loan Mortg. Corp. Derivative Litig.*, 643 F. Supp. 2d 790, 797-98 (E.D. Va. 2009), *aff'd sub nom. La. Mun. Police Emps. Ret. Sys. v. FHFA*, 434 F. App'x 188 (4th Cir. May 5, 2011).

the Court should depart from HERA's plain text to ensure "judicial review of . . . constitutional claims" is beside the point. *See id.* at 51. In all events, constitutional avoidance has no application here. It "is a tool for choosing between competing plausible interpretations of a provision," *Warger v. Shauers*, 135 S. Ct. 521, 529 (2014) (citation and internal quotation marks omitted), and "has no application in the absence of statutory ambiguity." *United States v. Oakland Cannabis Buyers' Co-op.*, 532 U.S. 483, 494 (2001). Here, there is no ambiguity in HERA's succession provision.[10]

2. Even If Plaintiffs' Claims Are Considered to Be Direct Rather Than Derivative, HERA Has Transferred Them to the Conservator

In HERA, "all means all," *Hennepin Cty.*, 742 F.3d at 822 (internal quotation marks and citation omitted), and the plain statutory language contains no exception for direct claims. Indeed, the existence of another express exception—namely, one permitting shareholders to prosecute claims they might have to liquidation proceeds pursuant to specific procedures following appointment of a receiver (12 U.S.C. § 4617(b)(2)(K)(i))—prohibits the creation of any implicit exceptions. *See Johnson*, 529 U.S. at 58. Moreover, because the Conservator already can pursue derivative claims that belong to the Enterprises themselves, given its succession to "all rights" of the Enterprises, the phrase "all rights . . . of any stockholder" must encompass direct shareholder claims if it is to have meaning.

Plaintiffs contend the language "with respect to [the Enterprises] and the assets of [the Enterprises]" limits HERA's succession provision to derivative claims. PB 48-49. But this interpretation is not plausible. Even if direct, Plaintiffs' claims are inextricably linked to the

[10] That Takings claims based on allegations concerning the Third Amendment are pending in the U.S. Court of Federal Claims (*see* PB 51 n.62), of course, does not require this Court to resolve any constitutional issues here. *Cf. Perry Capital*, 70 F. Supp. 3d at 239-46 (rejecting claims that the Third Amendment constitutes a taking).

Enterprises and their assets; their entire case is based on the allegation that the government "seize[d] the totality of the Companies' profits"—which, of course, are assets. Compl. ¶ 46.

Plaintiffs cite *Levin v. Miller*, 763 F.3d 667 (7th Cir. 2014), which addressed the succession language in FIRREA. Although resolved in conclusory fashion by the court, the issue of whether the succession provision extends to direct claims was not presented in *Levin*; indeed, as Plaintiffs acknowledge, the parties did not raise it. PB 50. Nevertheless, the concurring judge explained why the plain language of the succession provision *does* apply to direct claims: "It is not obvious to me that the language must be interpreted so narrowly [to apply only to derivative claims], nor did the cases cited [by the majority] confront this issue or require that result." *Levin*, 763 F.3d at 673 (Hamilton, J., concurring). Judge Hamilton recognized that the language "rights . . . of any stockholder" lacks meaning if the provision is limited to derivative claims, as the FDIC also succeeds to "all rights" of the institution itself. *Id.* "The doctrine that statutes should not be construed to render language mere surplusage . . . weighs in favor of a broader reach that could include direct claims." *Id.* Thus, if the Court reaches this issue, it should follow Judge Hamilton's careful analysis of the statute, not the majority's cursory conclusion.

III. The Treasury Preferred Stock, as Amended by the Third Amendment, Complies with Federal Law—the Only Law that Applies to It—and also with State Law

In addition to failing for lack of jurisdiction, Counts I and II—which allege the Third Amendment is void under Delaware and Virginia law—fail to state a claim. Federal law is the only law that applies, and the Third Amendment complies with it. In all events, the Third Amendment also complies with state law. *See* FHFA OB 26-30.

A. Federal Law Applies and Permits the Third Amendment to the Treasury Preferred Stock

The Enterprises are creatures of federal law—*not* state law—notwithstanding Plaintiffs' repeated and erroneous reliance on Delaware and Virginia law. *See* PB 2, 14-15. Congress itself

issued the federal charters creating the Enterprises, and those charters do not incorporate any state law. *See* 12 U.S.C. § 1716 *et seq.*; *id.* § 1451 *et seq.*

To the contrary, the Enterprises' charters expressly address the precise issues at stake in this litigation: the terms for issuance of stock and payment of dividends by the Enterprises. In particular, the charters authorize the Enterprises (and thus the Conservator) to: (1) issue preferred stock "on such terms and conditions as the board of directors shall prescribe," 12 U.S.C. § 1718(a); *id.* § 1455(f); and (2) make dividend payments to Enterprise stockholders in the manner "as may be declared by the board of directors." *Id.* § 1718(c)(1); *id.* § 1452(b)(1). Accordingly, the Enterprises' boards of directors (and thus the Conservator) have broad, unqualified authority under federal law to issue preferred stock and dividends in the manner the Enterprises' boards (and the Conservator) see fit. This necessarily includes the Third Amendment to the Treasury Preferred Stock and the payment of dividends on that stock. Additionally, under HERA, the Conservator has broad powers to conduct all business of the Enterprises and their boards—and also to exercise all rights and powers of the Enterprises' shareholders—which likewise include the power to execute the Third Amendment and issue dividends thereunder. *See supra* Sec. I; FHFA OB 10-18.

In opposition, Plaintiffs attempt to subject the Conservator to Delaware and Virginia law, relying on 12 C.F.R. § 1710.10, a regulation issued in 2002 by FHFA's predecessor agency, the Office of Federal Housing Enterprise Oversight ("OFHEO"). PB 17-19. But that regulation provides first and foremost that the Enterprises "shall comply with [their] applicable chartering acts and other Federal law, rules, and regulations." 12 C.F.R. § 1710.10(a). That regulation does no more than direct the Enterprises to follow Delaware law (or the law of the jurisdiction in which the principal office of the Enterprise sits) *only* with respect to issues *not* already addressed

in the Enterprises' federal charters. *See* 67 Fed. Reg. 38361 (Jun. 4, 2002). Indeed, in issuing the regulation, OFHEO specifically observed that:

> The chartering acts contain several provisions related to matters of corporate governance[, including] common and preferred stock. The chartering acts, however, are silent with respect to *other* corporate governance provisions that are commonly addressed for state-chartered corporations under State law.

Id. at 38362 (emphasis added); *see also id.* at 38364 (observing state law is *not* "incorporated wholesale by the election of [state] law by an Enterprise"). Here, because the charters are not "silent" regarding the terms for issuance of stock and payment of dividends by the Enterprises—they address those topics directly—no state law applies.

Additionally, the regulation makes clear that state law applies only "[t]o the extent not inconsistent with" the Enterprises' charters and other federal law. 12 C.F.R. § 1710.10(b). Here, Plaintiffs contend that Delaware and Virginia law supply more stringent requirements for the issuance of preferred stock than do the charters. PB 20-24. Plaintiffs are wrong in their interpretation of Delaware and Virginia law, *see infra* Sec. III(B), but any state law requirements that would conflict with HERA or the Enterprises' federal statutory charters, including imposing limits on the discretion of the Enterprises' boards or the Conservator to issue stock "on such terms and conditions" as they see fit, are preempted.

Conflict preemption applies even where "federal and state law [are] not . . . contradictory on their faces . . . . It is sufficient that the state law 'impose[s] . . . additional conditions' not contemplated by Congress." *Surrick v. Killion*, 449 F.3d 520, 532 (3d Cir. 2006) (second alteration in original) (citation omitted). Conflict preemption applies where state law "would frustrate the federal scheme." *Allis–Chalmers Corp. v. Lueck*, 471 U.S. 202, 209 (1985); *see also Barnett Bank of Marion Cty., N.A. v. Nelson*, 517 U.S. 25, 32 (1996) (holding conflict

preemption applies where federal statute provides banks broad authority to engage in an activity that state law prohibits). For example, in *Fasano v. Fed. Reserve Bank of N.Y.*, the Third Circuit held that a federal statute permitting Federal Reserve Banks to "dismiss [employees] at pleasure" preempted state statutes that "indisputably impose substantive and procedural burdens well beyond those imposed by federal law, and thereby frustrate Congressional intent to provide the Federal Reserve Banks with relatively unfettered employment discretion." 457 F.3d 274, 283 (3d Cir. 2006); *see also FDIC v. Bank of Boulder*, 911 F.2d 1466, 1472-73 (10th Cir. 1990) (federal law permitting FDIC to purchase assets preempted state law limiting such purchases). The same is true here: Congress provided the Enterprises with broad, unqualified discretion to issue preferred stock and dividends, thus preempting state statutes that would otherwise limit or impose conditions on that discretion.

Finally, the Treasury Stock Certificate itself provides that it "shall be construed in accordance with and governed by the laws of the United States," and that no state law applies "where such law is inconsistent with . . . any provision of this Certificate." *See* FHFA OB 26-28, Ex. E § 10(e) (Amended Treasury Stock Certificate). In opposition, Plaintiffs argue that, despite its plain terms, the Treasury Stock Certificate cannot override state law because stock certificates are "part of the corporate charter" and thus "cannot conflict with the applicable corporate law of the governing jurisdiction." PB 19. That is, Plaintiffs argue the Treasury stock is itself a "creature of state law." PB 19. Plaintiffs are wrong: as discussed above, the Enterprises are *federally* chartered and governed first and foremost by federal law. Thus, the Treasury Stock Certificate's governing law provision is fully consistent with the Enterprises' federal charters and is not derived from or beholden to state law.

In short, no federal law prevents the Conservator from agreeing to the Third Amendment.

B. Even If State Law Applied, the Treasury Stock Certificates, As Amended by the Third Amendment, Comply With Delaware and Virginia Law

Even if the Conservator had to comply with state law relating to the issuance and terms of preferred stock, Counts I and II would fail to state a claim because the Third Amendment does not violate the Delaware or Virginia statutes upon which Plaintiffs rely. *See* FHFA OB 28-30. Plaintiffs read limitations into these broad enabling statutes that simply are not there.

Plaintiffs rest their primary argument on a contention that the dividend adopted in the Third Amendment "is not paid at a 'rate'" and "is not payable 'in preference to' or 'in relation to' the dividends payable to other classes or series of stock." PB 21. But Plaintiffs do not—and cannot—explain how the dividend is not paid at a "rate" (even if set at 100%) or how the stock's senior priority position is not "in preference to" other classes of stock. Plaintiffs' other arguments that state law bars the Third Amendment likewise fail.

First, Plaintiffs attempt to trivialize the broad, enabling nature of the DGCL (*see* PB 20), but the DGCL is "widely regarded as the most flexible in the nation," *Jones Apparel Grp., Inc. v. Maxwell Shoe Co.*, 883 A.2d 837, 845 (Del. Ch. 2004). Indeed, DGCL § 151—the primary section on which Plaintiffs rely—is specifically designed to enable corporations "to provide for the flexible financing that is necessary to meet the unique funding needs of [a particular] enterprise." *Matulich v. Aegis Commc'ns Grp., Inc.*, 942 A.2d 596, 599 (Del. 2008). This section provides the company with "a *blank slate* on which to fill in the rights of different classes" of stock, on which "the drafter may parse those rights among multiple classes of stock as he or she sees fit." *Id.* at 599-600 (emphasis added). DGCL § 151(c) simply "does not . . . require" or mandate any particular rate or "any particular form of preference." *Shintom Co. v. Audiovox Corp.*, 888 A.2d 225, 230 (Del. 2005).

Plaintiffs' arguments with respect to Virginia law also fail. *See* PB 23. Like Delaware law, the Virginia code promotes flexibility. Indeed, it permits corporations to issue preferred stock that "[e]ntitle[s] the holders" to dividends "calculated in any manner." Va. Code § 13.1-638(C)(3). Plaintiffs cite *Drewry-Hughes Co. v. Throckmorton*, 92 S.E. 818 (Va. 1917), for the proposition that Virginia law requires preferred stock dividends to be "definitely fixed," but that case merely provides that "[t]he character and privileges of the preferred stock are definitely fixed by a sentence in the stock certificate issued to the preferred stockholders." *Id.* at 819. That standard is met here: the dividend is defined expressly in the Treasury Stock Certificates.

Second, Plaintiffs assert that the Third Amendment is impermissible because it may preclude the payment of dividends to non-Treasury shareholders such as Plaintiffs. PB 21-22, n. 22. But Plaintiffs' own stock certificates authorize the Enterprises to issue more senior stock, even if it would result in the dilution or elimination of the existing shareholders' ability to receive dividends.[11] And as the court in *Perry Capital* recognized, Enterprise shareholders have no contractual right to dividends. *See* 70 F. Supp. 3d at 236-39.

CONCLUSION

For the foregoing reasons and those in Treasury's briefs, FHFA, Fannie Mae, and Freddie Mac respectfully request the Court dismiss with prejudice all claims asserted against them.

[11] *See* FHFA OB Ex. B § 9 (Fannie Mae, Certificate of Designation for Series 2008-2 Preferred Stock); Ex. C § 8 (Freddie Mac, Certificate of Designation for Series Z Preferred Stock); Ex. D § 8 (Fannie Mae, Certificate of Designation for Series M Preferred Stock); *see also* Freddie Mac, Eighth Amended & Restated Cert. Design. for Common Stock, § 9 (*available at* http://goo.gl/lkj0S0)

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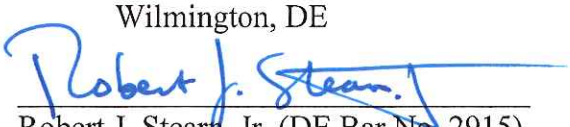
Wilmington, DE



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